UI Trust Fund Solvency: The Illinois Experience

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Implications of Trust Fund Insolvency

➢ Borrowing becomes necessary to meet benefit obligations

　» Professional second-guessers may need to be reminded that benefit payments are not in jeopardy, however.

➢ Federal UI taxes increase

　» Employers may be assessed federal penalty taxes.

➢ State budget is potentially affected

　» Debt interest payments cannot come from the UI Trust Fund.

Advantages of Bonding

➤ Avoidance of Federal Penalty Taxes
   » Bond proceeds can be used to pay off federal loans.

➤ Reduced Interest Rates
   » Capital market interest rates can be significantly lower than the rate charged on federal loans.

Advantages of Title XII Advances

➤ Administrative Ease
   » No special handling is required, administrative costs are negligible and interest does not even accrue in some cases.

➤ Maximum Flexibility
   » Loans are available essentially whenever they are needed, and advances can be repaid at the State's discretion.

Comparison of Interest Rates
2 & 5 Year Treasury Note Yields (bond market proxy) vs. Federal UI Rate
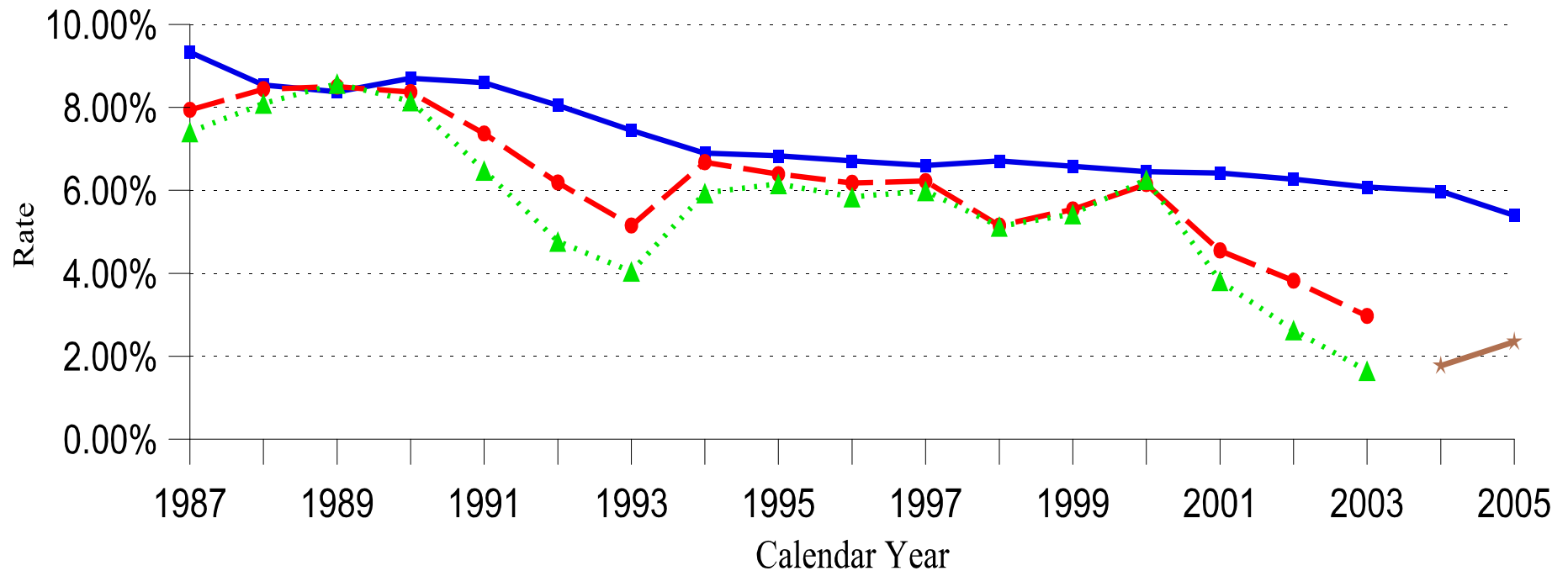

- Federal Rate Payable on Title XII Advances
- 5-Year Treasury Note Rate
- 2-Year Treasury Note Rate
- Average Illinois UI Bond Rate as of July 1st

Other Thoughts on Bonding

➤ Title XII Advances and Bonding are not mutually exclusive
  » Cash-flow borrowing beats bonding every time.

➤ Agreed Bill process can be helpful
  » Approval of both Business and Labor interests facilitates any proposals.

➤ Posting of reports lags the clearance of the cash
  » Fund capture strategy helps lessen the administrative burden.

➤ Financing team can have divided or disparate interests
  » Underwriters and lawyers have their own defined roles.

➤ Bonding is not a solution but rather a coping mechanism
  » Solvency is ultimate goal and bonding provides flexibility as to how you achieve it.

Countercyclical Nature of the System
UI Trust Fund is a Rainy Day Fund, not Pay-As-You-Go

Legend:
- Illinois' Year-End UI Trust Fund Balance (Y1)
- Illinois' Civilian Unemployment Rate (Y2)
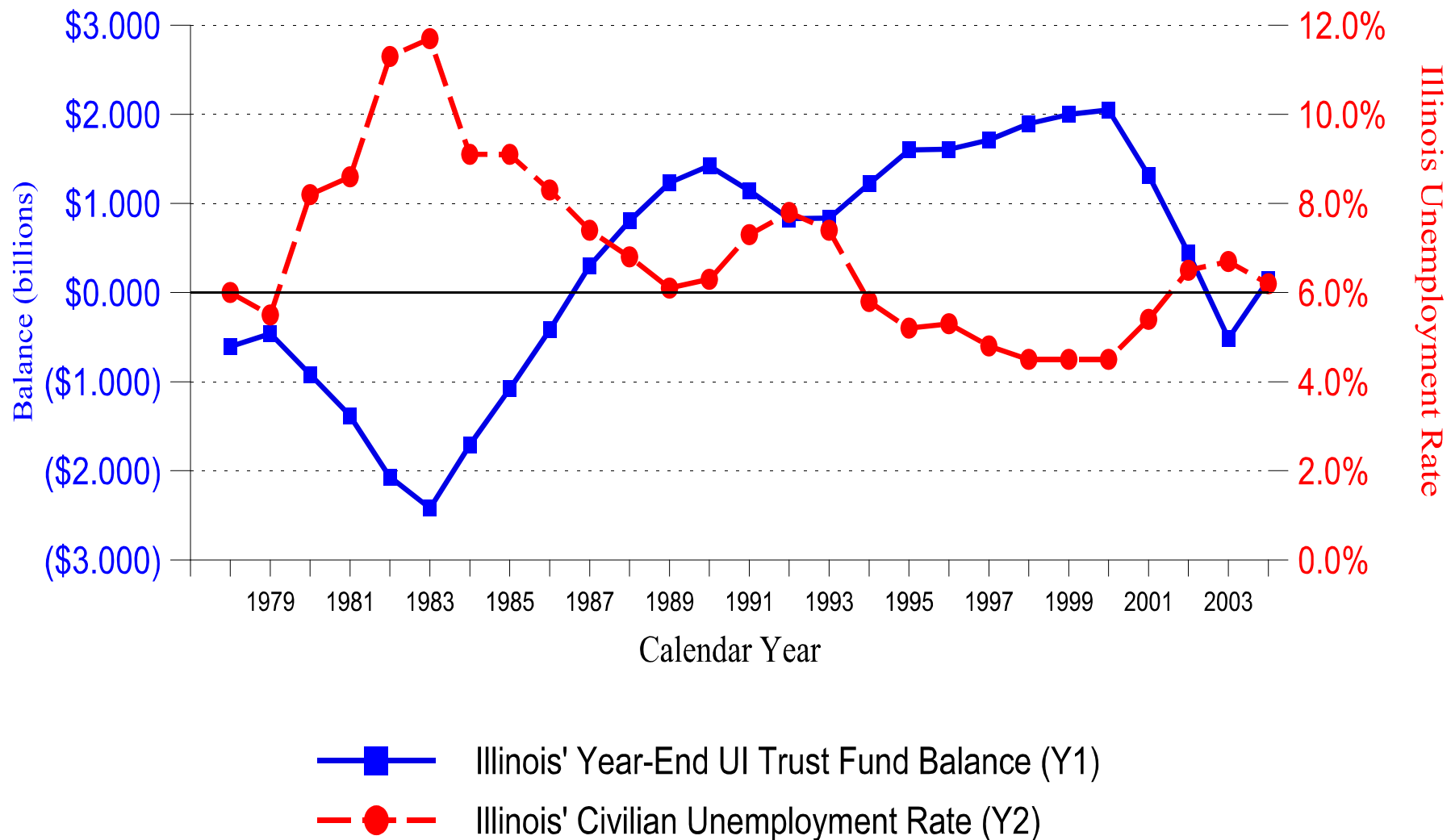
Lessons Learned

➢ Build a valid model
- » Backcasting (learn from past forecasts)
- » Independent economic forecasts (avoid appearance of conflict of interest)
- » Outside review (academic evaluation)

➢ Trust your model, but do not worship it
- » Model as a useful tool as well as a teacher (counter-intuitive) ...
- » ... but don't oversell model (conditional forecasts like the weather)
- » Not everything can be modelled (favorite toy, macro vs. micro)

➢ Beware inflation
- » Benefits typically indexed to inflation, is your taxable wage base indexed?

➢ Be mindful of the ever-present policy issue
- » Generous with UI benefits, if willing to be a high tax state
- » Attract business with low UI tax rates, if willing to be stingy with benefits

The IDES Trust Fund Model
Backcasting Year-End Trust Fund Balances with Precise Inputs
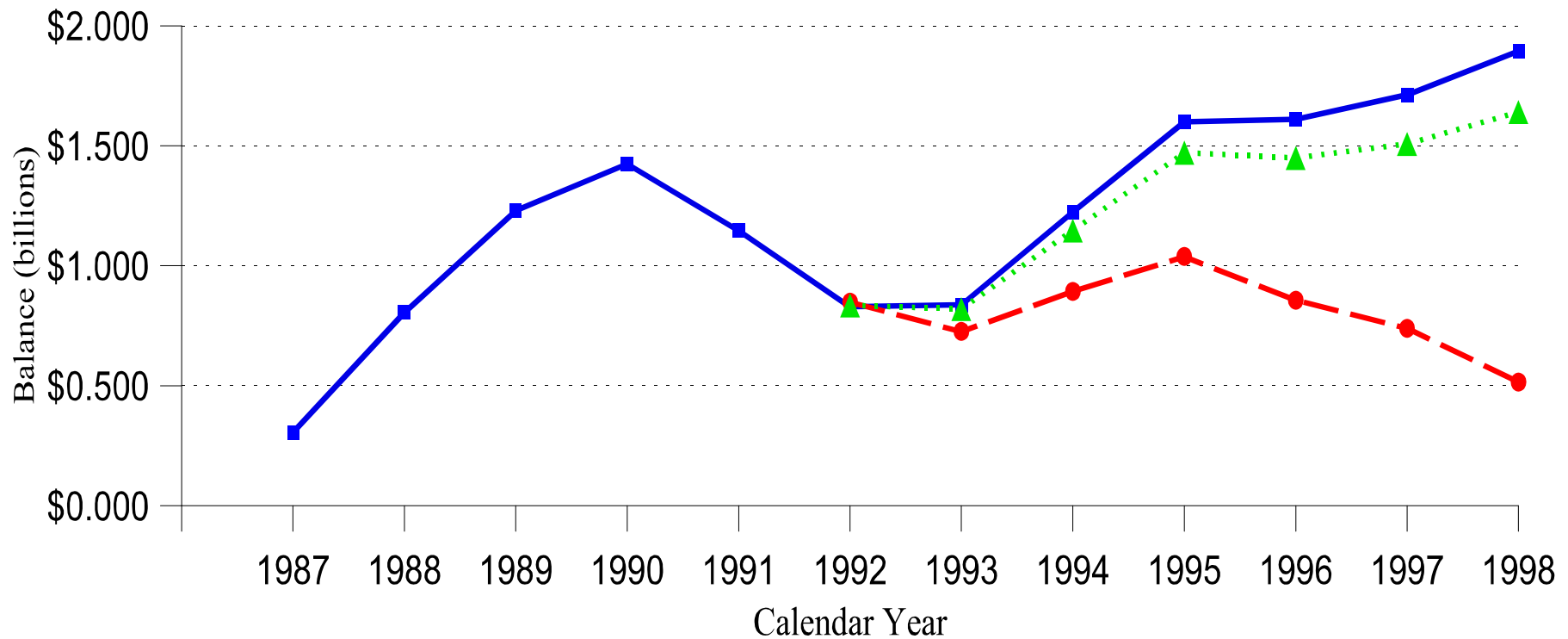
Actual

June 1992 Model: Projected Balances

June 1992 Model: with Precise Inputs

Precise Inputs are:

- Law Changes
- U.S. Unemployment Rate
- Wage Growth
- Interest Rates
- State-to-National Rate Ratio
- Insured-to-Total Unemployed Ratio
- Percent of Insured Unemployed Paid
- Labor Force Growth Rate

John Allen Paulos, Professor of Mathematics at Temple University and Best Selling Author:

"Many applications of mathematics are straightforward, but it's distressingly easy ... to identify one's model with 'reality' and to impute some property to reality that exists only in the model.

... the certainty of the mathematical conclusions derived from the model does not always extend to the assumptions, simplifications, and data that one uses to construct it.

Reality ... is indefinitely complex and impossible to capture completely in any mathematical model."

John Allen Paulos, Professor of Mathematics at Temple University and Best Selling Author:

"... stripped to their essence, many ... forecasts may be paraphrased ... 'Things will continue roughly as they have been ... until something changes.' "